STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Great Northern Utilities, Inc.	:	
	:	11-0059
Proposed General Increase in	:	
Water Rates	:	
	:	
Camelot Utilities, Inc.	:	
	:	11-0141
Proposed General Increase in Water and	:	
Sewer rates	:	
	:	
Lake Holiday Utilities Corporation	:	
	:	11-0142 on Rehearing
Proposed General Increase in	:	
Water Rates	:	(Cons.)

REPLY BRIEF ON REHEARING OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

JESSICA L. CARDONI
MICHAEL J. LANNON
Office of General Counsel
Illinois Commerce Commission
160 N. LaSalle, Ste. C-800
Chicago, IL 60601
Phone: (312) 793-3305
(312) 814-4368
Fax: (312) 793-1556
E-mail: jcardoni@icc.illinois.gov
mlannon@icc.illinois.gov

Counsel for the Staff of the

Illinois Commerce Commission

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REPLY BRIEF OF THE STAFF
OF THE ILLINOIS COMMERCE COMMISSION

Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned counsel, pursuant to Section 200.800 of the Illinois Commerce Commission's ("Commission" or "ICC") Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits its Reply Brief in the instant proceeding.

I. BACKGROUND

On December 22, 2010,[1] Great Northern Utilities, Inc. ("Great Northern" or "GNUI"), Camelot Utilities, Inc. ("Camelot" or "CUI"), and Lake Holiday Utilities Corporation ("Lake Holiday" or "LH") (collectively, "UI," "Utilities, Inc." or "the

[1] Camelot and Lake Holiday filed on December 30, 2010.

Companies") filed tariffs seeking a general increase in water and sewer rates.[2] On January 20, 2011 and February 9, 2011, the Commission entered Suspension Orders commencing the investigation concerning the propriety of the Companies' request for rate increases and on May 18, 2011 entered a Resuspension Order extending the suspension through November 29, 2011. At a status hearing on March 10, 2011, the Administrative Law Judge ("ALJ") assigned to this proceeding granted Staff's request to consolidate the three dockets. The ALJ established a schedule for the submission of pre-filed testimony, hearings, and briefs (*Tr.*, March 10, 2011, p. 7).

Camelot Homeowner's Association intervened on March 16, 2011, and various customers residing in the Camelot service territory filed Direct and Rebuttal Testimony. The People of the State of Illinois ("AG") intervened on June 9, 2011 and filed Rebuttal Testimony.

At the July 13 and 14, 2011 evidentiary hearing in this matter, witnesses for Utilities, Inc., Staff, and the AG testified. Staff and the Companies entered into a Stipulation[3] resolving all issues that had been disputed between the Companies and Staff. In that Stipulation, the Companies agreed to Staff's recommended revenue requirement, as well as all accounting adjustments recommended by Staff's witnesses in their Direct and Rebuttal Testimony. (Staff-Companies Joint Ex. No. 1 REV., at 2-3.) Neither Camelot Homeowners Association nor the AG participated in the Stipulation.

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[2] Great Northern and Lake Holiday sought only increases in water rates, not sewer.

[3] In fact, Staff and the Companies entered into a Stipulation on July 13 and then revised some calculations slightly and entered into the Revised Stipulation on July 14. The Revised Stipulation was filed on e-docket on July 15 as Staff-Companies Joint Ex. No. 1 REV.

The Commission issued a Final Order in the Docket on November 8, 2011, and Camelot and the AG Petitioned for Rehearing on the issue of rate shock. The Commission granted the Intervenors' Petitions for Rehearing on the Mitigation of Rate Shock Issue on December 21, 2011. The parties filed direct testimony on February 10, 2012, and rebuttal testimony on February 23, 2012. An evidentiary hearing was held on February 29, 2012. Mr. Philip Rukosuev testified for Staff, Mr. Michael Brosch testified for the AG, and Mr. Dimitry Neyzelman testified on behalf of the Companies. On March 16, 2012, the Companies, Staff, the Association, and the AG filed Initial Briefs ("IB").

This Reply Brief will respond to arguments from the other IBs. Staff will not respond to every argument proffered by every party in this Reply Brief. If Staff does not directly address each and every argument propounded, this does not mean that Staff is waiving its position, but rather that Staff feels it has previously adequately addressed such arguments or that the argument did not merit a response.

II. ARGUMENT

A. STAFF'S PRIMARY RECOMMENDATION WITH RESPECT TO RATE SHOCK MITIGATION

The arguments by the AG and the Association to implement a phase-in of rates in this proceeding should be rejected. The Commission should instead accept Staff's primary recommendation not to implement a phase-in or mitigation plan at this time. However, if the Commission does find that a mitigation plan should be implemented, it should adopt the alternative mitigation plan proposed by Staff.

There are good arguments against moving forward with any kind of program, including Staff's alternative mitigation plan. Under either Staff's or the AG's respective plans, full recovery of the approved revenue requirement would be delayed for several years and may result in a level of revenues insufficient to operate and maintain the Companies' water and sewer systems in a safe, adequate and reliable manner. (Staff IB on Rehearing, p. 5.) Further, a public utility is engaged in furnishing to the public different kinds of service; it should not and cannot be compelled to furnish such service at a loss.

Therefore, because a utility is entitled under the Act to recover its cost of providing utility service, Staff respectfully recommends the Commission not to delay a rate increase that reflects the reasonable cost of providing utility service, as the Commission correctly recognized in its Final Order in this proceeding.

The Company also makes an unconstitutional taking (or confiscatory) argument; although aimed primarily at the AG's proposed phase-in plan, it is also at least to some degree direct towards Staff's alternative phase-in proposal. Staff does not agree with the Companies argument that a phase-in plan is confiscatory. (UI IB, at 2 and 8.) A constitutional taking occurs in the public utility context only when the rates are so unjust as to be confiscatory or when the government's action destroy[s] the value of the property for all purposes for which it was acquired, and in doing so practically deprives the owner without due process of law. *See Duquesne Light Co. v. Barasch, 488 U.S. 299,* 307 (1989). There is absolutely no evidence of confiscatory rates here. The United States Supreme Court has further explained that:

> [T]he possibility that the application of a regulatory program may in some instances result in the taking of individual pieces of property is no justification for the use of narrowing constructions to curtail the program if compensation will in any event be available in those cases where a taking has occurred. Under such circumstances, adoption of a narrowing

> construction does not constitute avoidance of a constitutional difficulty; it merely frustrates permissible applications of a statute or regulation.
> *United States v. Riverside Bayview Homes, Inc.,* 474 U.S. 121, 128 (1985) (citations and quotations omitted); *see also Bell Atl. Tel. Co. v.FCC,* 24 F.3d 1441, 1445 (D.C. Cir. 1994) ("Of course the [Just Compensation] Clause prohibits only uncompensated takings; so long as [there is] a subsequent action for redress, generally no constitutional question arises and the judicial policy of avoiding such questions may not be applied.)..

Certainly, neither of the phase-in plans propose rates "so unjust" as to be confiscatory. Under both proposed phase-in plans, the AG and Staff propose reasonable carrying charges; the Companies can hardly consider this to be "uncompensated." While Staff agrees that the Company should recover its Commission-approved revenue requirement immediately, Staff does not agree that a Commission-approved phase-in plan would be an unconstitutional taking under its alternative proposal that includes a just and reasonable interest rate.

B. STAFF ALTERNATIVE PLAN WITH RESPECT TO RATE SHOCK MITIGATION – RIDER BSA ("BILL STABILIZATION ADJUSTMENT")

Although, Staff maintains its primary position that a phase-in plan should not be implemented, Staff addresses the benefits of its alternative phase-in proposal relative to the AG's phase-in proposal.

1. Staff's Phase-In Plan is Preferable to the AG's

If the Commission decides to order a rate mitigation plan, Staff recommends the Commission adopt its rate mitigation plan, also referred to as Rider BSA. This plan is preferable over the AG's phase-in plan. In fact, Staff's plan is supported by the Companies and the Association:

> *Staff's subordinate alternative is also superior to the Attorney General's proposal.*

(UI IB on Rehearing, pp.6-7 (emphasis added).)

> Because of the varying needs and financial situations of the residents at Camelot, the Association does not take a formal position on which of the phase-in plans the Commission should adopt - only that the Commission should adopt one of them. That being said, however, *the Staff's proposal does seem to reach an equitable balance between providing immediate relief to consumers from the rate shock they are presently experiencing and minimizing the extra costs they must bear in the future for the deferral*.

(Assoc. IB on Rehearing, p. 9 (emphasis added).)

Additionally, Staff notes that the AG, in its Initial Brief on Rehearing, recommended that the Commission adopt either its or Staff's proposed phase-in or rate mitigation plans. The AG is ultimately not opposed to Staff's plan:

> The People request that the Commission adopt the phase-in plan proposed by AG witness Michael Brosch, *or in the alternative, adopt the phase-in plan described by Staff witness Phillip Rukosuev*.

(AG IB on Rehearing, p.1 (emphasis added).)

2. Interest Rate on Deferred Bill Increases

Should the Commission be inclined to approve a phase-in or rate mitigation plan in this proceeding, the Commission should reject the Companies' erroneous recommendation to set the interest rate on the deferrals to its last authorized rate of return on rate base.

The Companies' criticism of Staff's proposed 3.2% carrying charge fails to recognize the key fact that the deferred revenues under Staff's alternative mitigation plan are recovered in a different manner than base rates. Therefore, they have a different level of risk. Financial theory posits that investors require higher returns to accept greater exposure to risk. (Staff Ex. 3.0, p. 33.) Different levels of risk result in different required rates of return. Base rates are subject to sales risks. That is, the company bears the risk of uncertain water sales. In contrast, deferred revenues under Staff's alternative mitigation plan are a debt obligation of the customer that must be paid back regardless of the amount of water used. Such a recovery mechanism is *less risky* than rate base cost recovery, as the recovery of deferrals would not be subject to sales variability. (Staff IB on Rehearing, p. 15.)

Further, the rate of return the Commission authorized in this proceeding includes an equity component. The Companies presented no evidence that they will use common equity to finance the small, relatively low-risk deferrals that have a relatively short, finite term. The AG agrees, stating that "[t]here is no reason to include an equity component, however, because the amount at issue will be subject to recovery over a relatively short period of time, and is an assured recovery more in the nature of debt." (AG IB on Rehearing, p. 8.)

Unless the Companies finance these deferrals in the exact same proportions as its authorized weighted average cost of capital, an assertion that wasn't established on the record by any UI witness, the carrying charge on the deferrals will not equal the Companies' actual financing cost, costs associated with the different types of capital UI employs. Any return on the deferrals above the actual cost the Companies incur to finance that asset would be unfair to ratepayers.

Lastly, in an attempt to discredit Staff's argument on the issue, the Companies make an unfounded attack on Staff's expert witness, stating that:

> The Staff witness, *who lacked the qualifications* of Staff's rate of return witness, was either *unable or unwilling to explain* why the cash working capital requirement created by a six year payment cycle should earn drastically less that [sic] the deferred cash payments under an ordinary 45 day billing cycle. The Staff witness also *failed to explain why he employed*

> *weighting of short term and long term debt that radically departed from the weighting used by Staff's rate of return witness*. In Staff's rate of return testimony, short term debt constituted only 6.45% of the capital structure. Yet short term debt under the phase-in plan was given a 91% weighting.

(UI IB on Rehearing, p.8 (emphasis added).)

The above argument is unsupported and must be rejected. First, the Staff witness provided all necessary documentation with supporting analysis to support each and every recommendation made to the Commission. There is simply nothing "radical" about Staff's proposal. As noted in the record, Staff's interest rate recommendation was developed with the assistance of the Commission Staff's Finance Department (*Tr.,* February 29, 2012, p. 54.) that routinely analyzes and provides rate of return recommendations to the Commission Second, cash-working capital is recovered through base rates, and as such, is lumped together with much longer lived assets such as water mains and other water plant and, as a consequence, gets the same rate of return.[4] This also means that cash working capital, which is recovered through base rates, has a different risk than deferred revenues under a rate mitigation plan. Third, contrary to the Companies' assertions, Staff did explain, *in detail*, both in testimony (with supporting schedules) and during cross-examination, why a weighting of short term and long term debt was employed.[5]

During cross examination, the Staff witness explained that:

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[4] Staff agrees that it would be possible to establish a separate rate of return for working capital that takes into account its shorter investment horizon; however, that was not done in these proceedings. Nonetheless, the Companies should be mindful what they ask for – in a future rate proceeding, a separate rate of return established for cash working capital would produce a much lower return than the return on longer lived rate base assets.

[5] Additional detailed explanation by Staff regarding weighting the short-term and long-term debt can be found at *Tr.*, February 29, 2012, pp. 52-53.

> [F]irst the 6.45 figure you're referring to, that's the short-term debt which is approximately $23 million out of the total of $366 million … [t]hat's just a percentage of how much there is a short-term debt outstanding compared to the debt and equity. It's in the final order. You can see the percentage, 6.45 percent. It's just how much short-term debt is there compared to the total outstanding amount.
>
> Now, my weighing is completely different. My weight is simply what is the relevance of the short-term debt based on an average of 3 year deferral, which is 90 percent. The 6.45 figure is just to reflect how much short-term debt is there compared to the total debt. I'm just showing what's the relevance of the short term debt for my calculation of the 3.25 [sic], the new interest rate on deferrals.[6] It's two completely different things actually.
>
> (*Tr.*, February 29, 2012, pp. 63-64.)

In sum, given the relatively short term nature of Staff's plan and the predictability of the resulting cash flows during that period, the Companies would likely use debt with a term to maturity that matches the average period for deferrals (i.e., three years). Unfortunately, as Staff Ex. 3.0, Schedule 3.3 shows, the Companies have no three-year debt outstanding. Therefore, Staff estimated a three-year interest rate by taking a weighted average of the Companies' short-term and long-term debt costs, or 3.20% (Staff Ex. 18.0 REV., pp. 14-15 and Schedule 18.2 Supplemental). Again, there is nothing radical in any respect about Staff's interest rate proposal.

3. Opt-In "explicit consent" Feature vs. Opt-Out "presumed consent" Feature

The concerns voiced by the Association concerning Staff's opt-in feature should be dismissed by the Commission.

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[6] Although the hearing transcript in the quoted section says 3.25, the correct value is 3.20. (*Tr.*, February 29, 2012, p. 49.)

The Association states:

> Finally, with respect to the question of whether such a plan should be available on an opt-in basis, an opt-out basis, or should be mandatory, the Association proposes the <u>second option</u> …
>
> (Association IB on Rehearing, p. 9 (emphasis added).)

First, Staff's opt-in feature allows customers the choice to pay future bills in full or to finance a portion of their bills. In this way, UI customers decide for themselves how best to manage their utility costs. Second, because an opt-out feature forces customers to register their unwillingness to participate in the program, some customers, who otherwise are wholly capable of paying their bills in full, may forget to opt-out and be wedged into a plan that forces them to pay interest on accumulating deferred balances. In contrast, Staff's plan not only gives customers the ability to opt-in within a 90 day sign-up window, but also the ability to terminate their participation in the plan voluntarily, *at any time*, with the balance of deferral amounts due immediately. (*See* Staff IB on Rehearing, Appendix A, Paragraph # 11.) Implementing an opt-out method will result in a larger customer base but one of lesser quality, because those who don't take prompt action will by default be enrolled in a rate mitigation program whether or not they intended to enroll. The inverse is true of an opt-in --- those who don't take prompt action will *not* be enrolled in a rate mitigation program. The concern in having a larger but lower quality list of enrollees is that those who were inadvertently enrolled will eventually unsubscribe or complain, or worse, pay interest on deferrals they did not need to or desire to carry in the first place.

Therefore, Staff respectfully requests the Commission to incorporate an opt-in feature in the event the Commission adopts a rate mitigation proposal in this proceeding.

4. Recovery of Costs Associated with Modifying the Billing System and Increased Uncollectible Expenses

Staff objects to the Companies' continued assertion that "the Commission should provide a mechanism for *recovery of the costs required to modify the billing system and administer the plan and increased uncollectible expenses*, either in the form of *a rider* or authorization to defer recovery until the next rate case." (UI IB on Rehearing, p. 9 (emphasis added).) There is simply no basis for the Commission to address costing issues related to any mitigation program in this proceeding.

With respect to uncollectible expenses, the Companies point to Commonwealth Edison Company, stating that it has an automatic adjustment rider that enables it to recover increases in uncollectible expenses on a timelier basis. (UI IB on Rehearing, p. 5.) However, the ability to file an automatic adjustment clause tariff for uncollectibles expense is granted to electric and gas public utilities by the General Assembly through specific provisions in the Act (Sections 5/16-111.8 and 5/19-145.) Recent Appellate Court decisions have severely limited the Commission's discretion in allowing cost recovery through a rider mechanism. *See generally* Madigan v. ICC*, Opinion,* No. 09-0263, App. Ct., 2nd Dist. (March 19, 2012) (ComEd's Rider SMP); *Madigan v. ICC*, 958 NE2d 405 (2nd Dist. 2011) (PGNS' Rider ICR); *Commonwealth Edison v. ICC*, 937 NE2d 685 (2nd Dist. 2010) (ComEd's Rider SMP).

The Companies' argument that uncollectibles expense will increase with postponement of the revenue recovery is misguided. (UI IB, at 3.) From a purely logical standpoint, lowering utility bills would be expected to *decrease* uncollectibles, because individuals may find their new utility bills to be more affordable under a phase-in plan.

The Companies cite to the Commission's Order in Docket No. 06-0411 which states that ComEd estimated 80 percent of the amounts deferred by participants in the rate mitigation program would be uncollectible. First, it is important to note that Utilities, Inc. has not provided any estimate of what they believe their uncollectibles expense would be under a phase-in plan. Second, merely because ComEd provided an estimate of their uncollectibles has no bearing in this Docket. In fact, the Companies ignore the Commission's findings, which expressly noted that ComEd would incur these uncollectibles even absent a phase-in program. (Order, Docket No. 06-0411, Dec. 20, 2006, p. 20.) Finally, the uncollectible rate/expense included in base rates is assumed to be the rate that the Company (or Commission) expects under the Company's new revenue requirement. In the beginning years of a rate phase in, the rates will be less than they would be if they reflected the full revenue requirement; as such, the uncollectibles should be lower than they would be under the full revenue requirement rates. In the later years of the phase in, the rates will be greater than they would if they reflected the full revenue requirement; as such, the uncollectibles should be greater than they would be under the full revenue requirement rates. Generally, the uncollectibles will probably even out over the years and come close to the amount of uncollectibles in base rates.

With respect to costs required to modify the billing system and administer a phase-in plan, to the extent these costs are in the Companies' test year, the Companies should seek their recovery in the next rate case. In other words, the Companies should not be allowed any form of special recovery of these costs.[7] It is not the Commission's duty to guarantee in this case that mitigation plan costs be recovered in an unknown test year for a future rate case. Rather, the standards that apply to other utility costs should apply to any mitigation plan costs as well. (Staff IB on Rehearing, pp. 15-16.)

5. Accumulated Deferred Income Taxes ("ADIT") Condition

The AG argues that, regardless of which phase-in plan the Commission adopts in this proceeding, the resulting regulatory asset should be netted against the related ADIT when calculating any allowable interest charges on that regulatory asset. (AG Ex. 2.0 on Rehearing, pp. 13-14 and AG Ex. 2.3 on Rehearing , p. 7.)

The Companies reflected this approach in their schedules. For example, if Staff's alternative plan is adopted, deferred operating and maintenance ("O&M") expenses will be deferred and amortized over three years. ADIT on deferred O&M expenses will be recorded to realize the temporary timing differences in recovering deferred revenues. The regulatory asset will be netted against the related ADIT when calculating any interest charges. (Utilities' Ex. 2.0 on Rehearing, p. 4; Sch. 5 C-W & C-S & GN, page 2.) Staff is not opposed to the AG's proposed condition that the

[7] In Docket No. 06-0411, ComEd asked the Commission to make a similar finding regarding its costs for its rate mitigation program (Rider RRS) and the Commission declined to do so. (Staff IB on Rehearing, p. 15.)

regulatory asset resulting from a phase-in plan should be netted against the related ADIT when calculating any allowable interest charges on that regulatory asset.

III. CONCLUSION

For the reasons set forth above, Staff respectfully requests that the Commission's Final Order in the instant proceeding reflect Staff's recommendations above.

Respectfully submitted,

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JESSICA L. CARDONI
MICHAEL J. LANNON

Counsel for the Staff of the Illinois Commerce Commission

March 30, 2012

JESSICA L. CARDONI
MICHAEL J. LANNON
Office of General Counsel
Illinois Commerce Commission
160 N. LaSalle, Ste. C-800
Chicago, IL 60601
Phone: (312) 793-3305
(312) 814-4368
Fax: (312) 793-1556
E-mail: jcardoni@icc.illinois.gov
mlannon@icc.illinois.gov